

§ 3.36

12 CFR Ch. I (1–1–16 Edition)

Where:

(1) DF_i = the national bank's or Federal savings association's unfunded commitment to the default fund;

(2) DF_{CM} = the total of all clearing members' unfunded commitment to the default fund; and

(3) K^*_{CM} as defined in paragraph (d)(3)(ii) of this section.

(B) For a national bank or Federal savings association that is a clearing member of a QCCP with a default fund supported by unfunded commitments and is unable to calculate K_{CM} using the methodology described in paragraph (d)(3)(iii) of this section, K_{CM} equals:

$$K_{CM_i} = \frac{IM_i}{IM_{CM}} \cdot K^*_{CM}$$

Where:

(1) IM_i = the national bank's or Federal savings association's initial margin posted to the QCCP;

(2) IM_{CM} = the total of initial margin posted to the QCCP; and

(3) K^*_{CM} as defined in paragraph (d)(3)(ii) of this section.

(iv) *Method 2.* A clearing member national bank's or Federal savings association's risk-weighted asset amount for its default fund contribution to a QCCP, RWA_{DF} , equals:

$$RWA_{DF} = \text{Min} \{12.5 * DF; 0.18 * TE\}$$

Where:

(A) TE = the national bank's or Federal savings association's trade exposure amount to the QCCP, calculated according to section 35(c)(2);

(B) DF = the funded portion of the national bank's or Federal savings association's default fund contribution to the QCCP.

(4) *Total risk-weighted assets for default fund contributions.* Total risk-weighted assets for default fund contributions is the sum of a clearing member national bank's or Federal savings association's risk-weighted assets for all of its default fund contributions to all CCPs of which the national bank or Federal savings association is a clearing member.

§ 3.36 Guarantees and credit derivatives: substitution treatment.

(a) *Scope—(1) General.* A national bank or Federal savings association may recognize the credit risk mitigation benefits of an eligible guarantee or eligible credit derivative by sub-

stituting the risk weight associated with the protection provider for the risk weight assigned to an exposure, as provided under this section.

(2) This section applies to exposures for which:

(i) Credit risk is fully covered by an eligible guarantee or eligible credit derivative; or

(ii) Credit risk is covered on a pro rata basis (that is, on a basis in which the national bank or Federal savings association and the protection provider share losses proportionately) by an eligible guarantee or eligible credit derivative.

(3) Exposures on which there is a tranching of credit risk (reflecting at least two different levels of seniority) generally are securitization exposures subject to §§ 3.41 through 3.45.

(4) If multiple eligible guarantees or eligible credit derivatives cover a single exposure described in this section, a national bank or Federal savings association may treat the hedged exposure as multiple separate exposures each covered by a single eligible guarantee or eligible credit derivative and may calculate a separate risk-weighted asset amount for each separate exposure as described in paragraph (c) of this section.

(5) If a single eligible guarantee or eligible credit derivative covers multiple hedged exposures described in paragraph (a)(2) of this section, a national bank or Federal savings association must treat each hedged exposure as covered by a separate eligible guarantee or eligible credit derivative and

must calculate a separate risk-weighted asset amount for each exposure as described in paragraph (c) of this section.

(b) *Rules of recognition.* (1) A national bank or Federal savings association may only recognize the credit risk mitigation benefits of eligible guarantees and eligible credit derivatives.

(2) A national bank or Federal savings association may only recognize the credit risk mitigation benefits of an eligible credit derivative to hedge an exposure that is different from the credit derivative's reference exposure used for determining the derivative's cash settlement value, deliverable obligation, or occurrence of a credit event if:

(i) The reference exposure ranks *pari passu* with, or is subordinated to, the hedged exposure; and

(ii) The reference exposure and the hedged exposure are to the same legal entity, and legally enforceable cross-default or cross-acceleration clauses are in place to ensure payments under the credit derivative are triggered when the obligated party of the hedged exposure fails to pay under the terms of the hedged exposure.

(c) *Substitution approach*—(1) *Full coverage.* If an eligible guarantee or eligible credit derivative meets the conditions in paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is greater than or equal to the exposure amount of the hedged exposure, a national bank or Federal savings association may recognize the guarantee or credit derivative in determining the risk-weighted asset amount for the hedged exposure by substituting the risk weight applicable to the guarantor or credit derivative protection provider under § 3.32 for the risk weight assigned to the exposure.

(2) *Partial coverage.* If an eligible guarantee or eligible credit derivative meets the conditions in §§ 3.36(a) and 3.37(b) and the protection amount (P) of the guarantee or credit derivative is less than the exposure amount of the hedged exposure, the national bank or Federal savings association must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk

mitigation benefit of the guarantee or credit derivative.

(i) The national bank or Federal savings association may calculate the risk-weighted asset amount for the protected exposure under § 3.32, where the applicable risk weight is the risk weight applicable to the guarantor or credit derivative protection provider.

(ii) The national bank or Federal savings association must calculate the risk-weighted asset amount for the unprotected exposure under § 3.32, where the applicable risk weight is that of the unprotected portion of the hedged exposure.

(iii) The treatment provided in this section is applicable when the credit risk of an exposure is covered on a partial pro rata basis and may be applicable when an adjustment is made to the effective notional amount of the guarantee or credit derivative under paragraphs (d), (e), or (f) of this section.

(d) *Maturity mismatch adjustment.* (1) A national bank or Federal savings association that recognizes an eligible guarantee or eligible credit derivative in determining the risk-weighted asset amount for a hedged exposure must adjust the effective notional amount of the credit risk mitigant to reflect any maturity mismatch between the hedged exposure and the credit risk mitigant.

(2) A maturity mismatch occurs when the residual maturity of a credit risk mitigant is less than that of the hedged exposure(s).

(3) The residual maturity of a hedged exposure is the longest possible remaining time before the obligated party of the hedged exposure is scheduled to fulfil its obligation on the hedged exposure. If a credit risk mitigant has embedded options that may reduce its term, the national bank or Federal savings association (protection purchaser) must use the shortest possible residual maturity for the credit risk mitigant. If a call is at the discretion of the protection provider, the residual maturity of the credit risk mitigant is at the first call date. If the call is at the discretion of the national bank or Federal savings association (protection purchaser), but the terms of the arrangement at origination of

the credit risk mitigant contain a positive incentive for the national bank or Federal savings association to call the transaction before contractual maturity, the remaining time to the first call date is the residual maturity of the credit risk mitigant.

(4) A credit risk mitigant with a maturity mismatch may be recognized only if its original maturity is greater than or equal to one year and its residual maturity is greater than three months.

(5) When a maturity mismatch exists, the national bank or Federal savings association must apply the following adjustment to reduce the effective notional amount of the credit risk mitigant: $P_m = E \times (t - 0.25) / (T - 0.25)$, where:

(i) P_m = effective notional amount of the credit risk mitigant, adjusted for maturity mismatch;

(ii) E = effective notional amount of the credit risk mitigant;

(iii) t = the lesser of T or the residual maturity of the credit risk mitigant, expressed in years; and

(iv) T = the lesser of five or the residual maturity of the hedged exposure, expressed in years.

(e) *Adjustment for credit derivatives without restructuring as a credit event.* If a national bank or Federal savings association recognizes an eligible credit derivative that does not include as a credit event a restructuring of the hedged exposure involving forgiveness or postponement of principal, interest, or fees that results in a credit loss event (that is, a charge-off, specific provision, or other similar debit to the profit and loss account), the national bank or Federal savings association must apply the following adjustment to reduce the effective notional amount of the credit derivative: $P_r = P_m \times 0.60$, where:

(1) P_r = effective notional amount of the credit risk mitigant, adjusted for

lack of restructuring event (and maturity mismatch, if applicable); and

(2) P_m = effective notional amount of the credit risk mitigant (adjusted for maturity mismatch, if applicable).

(f) *Currency mismatch adjustment.* (1) If a national bank or Federal savings association recognizes an eligible guarantee or eligible credit derivative that is denominated in a currency different from that in which the hedged exposure is denominated, the national bank or Federal savings association must apply the following formula to the effective notional amount of the guarantee or credit derivative: $P_c = P_r \times (1 - H_{FX})$, where:

(i) P_c = effective notional amount of the credit risk mitigant, adjusted for currency mismatch (and maturity mismatch and lack of restructuring event, if applicable);

(ii) P_r = effective notional amount of the credit risk mitigant (adjusted for maturity mismatch and lack of restructuring event, if applicable); and

(iii) H_{FX} = haircut appropriate for the currency mismatch between the credit risk mitigant and the hedged exposure.

(2) A national bank or Federal savings association must set H_{FX} equal to eight percent unless it qualifies for the use of and uses its own internal estimates of foreign exchange volatility based on a ten-business-day holding period. A national bank or Federal savings association qualifies for the use of its own internal estimates of foreign exchange volatility if it qualifies for the use of its own-estimates haircuts in § 3.37(c)(4).

(3) A national bank or Federal savings association must adjust H_{FX} calculated in paragraph (f)(2) of this section upward if the national bank or Federal savings association revalues the guarantee or credit derivative less frequently than once every 10 business days using the following square root of time formula:

$$H_{FX} = 8\% \sqrt{\frac{T_M}{10}}, \text{ where } T_M \text{ equals the greater of 10 or the number of days between}$$

reevaluation.